Grant Street Asset Management, Inc.

INVESTMENT ADVISORS

GRANT STREET ASSET MANAGEMENT, INC.
QUARTERLY LETTER
2nd QUARTER 2023
JULY 14, 2023

With the first half of 2023 in the books, investors and economists should be pleased with the strong start to the year. The fundamental economic data continues to support the story of a durable economy powered by a strong consumer. Economic data has been generally positive, but also surprisingly resilient to many investors. For example, the recession that many have been calling for the last eighteen months has yet to show up. Employment remains strong and the consumer has maintained strength in spending, despite inflation remaining rather sticky in some segments. Companies also continue to post respectable earnings. These positive signs are undoubtedly in the rearview, and we do expect the economy and inflation to slow going into 2024. While we believe that the bulk of the interest rate increases which caused so much havoc on markets last year is behind us, there is typically a nine to twelve month lag before the effect of an increase is felt throughout the economy. Most of the rate hikes occurred in the 2nd and 3rd quarters of 2022. As a result, we are expecting the full impact of the increases to be reflected in the data we track throughout out the remainder of this year and into 2024. We anticipate tighter credit for businesses and consumers later this year, leading to a natural slowdown in economic activity in 2024. However, we believe any recession will be mild because the strength of the labor market is likely to cushion the impact of these forces overall. The biggest risk to this forecast is the Federal Reserve's path forward with interest rates.

The primary battle that Federal Reserve (the "Fed") officials and the consumer alike are fighting continues to be inflation. The headline year-over-year inflation rate measured by the consumer price index (CPI) has fallen from 9.1% in June 2022 to 4.0% at the most recent reading in May. Although inflation has been drastically cut, the Fed is determined to rein-in the headline rate closer to its 2% mandate. The Fed meetings this past quarter resulted in one 0.25% rate increase in May, followed by the long-awaited "pause" in June. Although the Fed elected not to raise rates during their June meeting, their language has suggested that investors should expect an additional hike or two this year.

The labor market is beginning to show slight signs of softness, but it remains well equipped to handle a modest slow down. Headline unemployment is hovering around an extremely low rate of 3.7%. The number of job openings in the U.S. still outpaces the number of workers available by 1.6 to 1. This tightness in the labor market will continue to pressure wages upward and slow the battle against inflation. While jobless claims crept up to 240,000 as of the end of the quarter, these numbers remain well-below the level historically associated with every recession since 1980 (375,000).

Turning to the consumer, spending habits over the past year have shifted from material goods to more services and experience-based expenditures, such as travel. Consumers are refusing to delay travel despite limited hotel inventory and airfare ticket prices being near an all-time highs, up 25% from last year. This influx of travel benefits not just airlines and airports, but restaurants and bars as well. Sales at restaurants and bars are up 8.0% year-over-year as of May. We believe this spike in spending on services is an aftershock of Covid and excess stimulus income, and spending should pull back modestly over the next year. We are not expecting a steep drop, however, due to a robust employment market and a historically healthy consumer.

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The economic data has been more resilient than investors were anticipating at the start of this calendar year and markets have reacted positively. As reflected below, both equities and fixed income posted a solid start to the year:

Equity Index	**2Q 2023**	**YTD thru 6/30/23**
S&P 500 (Large Companies)	8.7%	16.9%
Nasdaq 100 (Technology-heavy)	15.4%	39.4%
S&P 400 (Mid-sized Companies)	4.9%	8.8%
Russell 2000 (Small-sized Companies)	5.2%	8.1%
MSCI EAFE (Europe, Australia & Far East)	3.0%	11.7%
MSCI Emerging Markets	0.9%	4.9%
MSCI ACWI (All Country World Index)	5.8%	13.1%

Source: Morningstar Direct

Fixed Income Index	**2Q 2023**	**YTD thru 6/30/23**
Morningstar US Core Bond	-0.8%	2.1%
U.S. 10-year Treasury	-1.9%	1.7%
ICE BofA 1-3 Yr. U.S. Treasury	-0.6%	1.0%
U.S. 3-month T-Bills	1.2%	2.3%
ICE BofA U.S. High Yield	1.6%	5.4%
ICE BofA 7-10 Yr. Municipal Bond	-0.7%	1.8%

Source: Morningstar Direct

In reviewing capital markets for the second quarter, equities continued to build on their strong start to the year and accelerated throughout the quarter. Much of the positive performance year-to-date has been driven by a handful of mega-cap technology stocks. For the quarter, the technology sector gained over 14% and is up nearly 40% year-to-date. This is a significant contrast to small and mid-sized companies up only 8% YTD. Many of the top-performing names are also the biggest names within the S&P 500 index. In fact, the top five names in the index have accounted for nearly 90% of the index return this year. It remains to be seen if this small group of stocks will continue this trend, or if the rally may broaden out to the hundreds of other companies trading at much more attractive valuations. International stocks, as measured by the MSCI EAFE Index, returned 3% for the quarter and now lag slightly behind the S&P 500 for the year. Although international equities are still trading at a discounted valuation relative to domestic equities, we believe domestic equities are better equipped to weather a possible recession.

Fixed income markets have somewhat normalized since late 2022. Core bonds experienced a slight negative return for the quarter, but they are still positive just over 2% for the year. The yield on the 10-year U.S. Treasury fluctuated in the range of 3.29% to 3.85% for the quarter. It finished the quarter at 3.82%, virtually where it began the year. Among shorter-term bonds, the 2-year and 6-month U.S. Treasury yields were at 4.87% and 5.48%, respectively, and the curve remains inverted. While short-term rates are nominally higher than intermediate rates, the potential for price appreciation during periods of falling interest rates are minimal on the short end. As the Fed reaches the end of its rate hikes, reducing short-term and adding intermediate term bonds is a solid fixed income strategy.

Within client portfolios, GSAM's investment committee has held the equity allocation mostly stable through the second quarter, and we continue to overweight U.S. large cap relative to mid-cap, small-cap and international stocks. Our primary adjustment within the second quarter was within fixed income. The investment committee took advantage of the increase in the 10-year Treasury yield to reduce short-term bonds and to add to intermediate-term bonds. We believe the lion's share of the Fed's interest rate hikes are behind us, and we will continue to be opportunistic by shifting to intermediate bonds when the market drives the 10-year treasury yield higher. We want to lock in higher intermediate term rates to maximize appreciation potential in the future. We are also exploring additional opportunities within large cap value and small cap stock strategies in our current research, given historically attractive valuations.

In closing, the second quarter brought with it a continued sense of resiliency for the U.S. economy and a consumer that has weathered the inflation and higher interest rate storm better than most anticipated. Businesses have also been agile to maximize earnings, despite weakening revenues. While we anticipate the employment environment to remain solid, we expect to see some deterioration in economic data in the back half of this year and into 2024. Fixed income should provide positive defensive returns, while equities will likely experience a broad range of returns depending on asset class. While the S&P 500 index has reached new highs, it is being driven by an incredibly narrow group of stocks. Opportunities are plentiful for long-term appreciation within equities once you look outside that elite group, and we remain focused on those prospects. Ultimately, we are long-term investors and are committed to sustaining our prudent approach as your steward of capital. We thank you for your continued confidence in Grant Street Asset Management.